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# Japan's Airline Industry: A Takeoff for Deregulation?

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An Intelligence Assessment

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## **Japan's Airline Industry: A Takeoff for Deregulation?**

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**An Intelligence Assessment**

This paper was prepared by [ ] Office of  
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**Key Judgments***Information available  
as of 1 August 1985  
was used in this report.*

As a result of the growth in competition in the international civil aviation marketplace, Tokyo is under increasing foreign and domestic pressure to deregulate Japan's airline industry:

- Except for Japan Air Lines (JAL)—which now dominates the market—the Japanese airline industry has much to gain from deregulation, and the smaller airlines in Japan are winning support for the idea from some members of the Liberal Democratic Party (LDP) and the business community.
- The mood of business in Japan, moreover, favors the steps toward deregulation taken by the Nakasone administration in a variety of sectors as part of its effort to shrink the size of government and its financial burden. Keidanren—Japan's most influential business organization—for example, has called for deregulation of transportation businesses, including civil aviation.

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Even the Ministry of Transportation, which views deregulation as undercutting its powers, is showing signs of moving to lift some controls over international routes and fare setting:

- The Ministry, however, is not sold on a program to liberalize the marketplace and, in our view, will probably try to hold down the pace of deregulation.
- The capacity limitations at major Japanese airports are also likely to cause further delays in any step to open up the market.

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Nonetheless, we believe the pace of deregulation could quicken if new airports open as scheduled in the late 1980s and early 1990s and if industry pressure on politicians to expedite the deregulatory process continues to mount. Overall, deregulation of Japan's airline industry could benefit the United States by offering new bargaining chips in bilateral civil air negotiations and providing an expanded market for US aircraft producers and construction companies.

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## Japan's Airline Industry: A Takeoff for Deregulation?

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Changes in the international civil aviation environment over the past decade are spurring Japanese domestic and air cargo carriers to press for revisions in Tokyo's civil aviation policies. Demand for air transport services in Asia and to the United States has been the major impetus. In 1975, for the first time, more Japanese traveled to the United States than Americans to Japan. By 1979 most trans-Pacific airline traffic flowed to, from, or through Japan. The combined effect of increased domestic demand and the growth in Japan's through-flight role in the Pacific has increased pressure for more slots and frequencies for incoming aircraft.

Lighter and smaller package-express-style cargo also is making air transport of goods increasingly attractive. As a case in point, Japan's air cargo exports increased by almost 34 percent in 1984 over the previous year. The Transportation Ministry has forecast that the opening of a new international airport in Osaka will almost double the cargo tonnage now flown. The Ministry projects that 820,000 tons of cargo will pass through Japan's new Kansai International Airport annually once it is completed in 1993; 714,000 tons already flow through Narita.

### Major Actors in the Political Battle . . .

The deregulation of the US airline industry in 1978 has had a sizable impact on Japan. In addition to stimulating the international trend toward deregulation, it has energized Japan's domestic carriers to lobby harder in Tokyo for their share of the profitable Pacific market and a place alongside JAL. All Nippon Airways (ANA) and Toa Domestic Airlines (TDA) are pressuring the government to break JAL's monopoly over international passenger flights. Their main goal is to win licenses to operate regularly scheduled flights overseas, particularly to the United States, but they also want a portion of the international cargo market.

ANA opened its bid for the cargo business in 1978, when it established Nippon Cargo Airlines (NCA) in cooperation with six shipping lines. In 1982 NCA began to seek entry into the United States. In the emerging market for door-to-door delivery of cargo and small packages, Sagawa Express—Japan's small package delivery service—has linked up with Federal Express to provide deliveries throughout the Pacific. Sagawa and Federal are positioned to begin services as early as April 1987, although their venture must wait for the Transportation Ministry to fashion required regulatory and legal changes. Its failure to take this step toward deregulation could delay startup by as much as two or three years. Depending on the Ministry's behavior, several of Japan's larger cargo companies will probably also want to compete in this market.

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### . . . and Their Potential Influence on the LDP

JAL, the established domestic air carriers, and the new cargo firms all are targeting the same political decision makers to lobby their cases. Their focus is the LDP's Aviation Committee, which is currently considering changes in Japan's aviation policies. Not surprisingly, the committee's internal lineup mirrors the split in the industry over deregulation:

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- The JAL group on the committee essentially pushes JAL's interests and opposes pressure to break the airline's monopoly on regularly scheduled international flights. For the last three decades JAL supporters have dominated the committee, and they are likely to put up a hard fight against efforts by ANA and TDA to win access to new passenger routes established under the May 1985 US-Japan provisional agreement.

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**Japan's Major Airlines**

**Japan Air Lines:** Established October 1953. Japan's flag carrier; among international airlines, ranks first in cargo handling and second in number of passengers carried. About 38-percent government ownership. Has exclusive rights to regularly scheduled international passenger flights based on Japan's 1972 aviation constitution. Also operates domestic routes and manages hotels through its subsidiaries. Established Southwest Airlines—Japan's fourth-largest carrier—with local Okinawan enterprises in 1967; services flights throughout islands in Okinawa and Kagoshima prefectures. Wholly owns Japan Asia Airways (JAA), established in 1975, which operates passenger and cargo flights between Japan and Taiwan.

Capital—\$255 million<sup>a</sup>

Aircraft purchase plans—12 Boeing 747s, 9 Boeing 767s by 1989

**All Nippon Airways:** Established December 1952. Largest domestic airline; ranked sixth in world in number of passengers carried; largest passenger carrier outside the United States and Soviet Union. Began international charter flights in September 1984. Has partial ownership of Nippon Cargo Airlines. Also services routes to Hokkaido, Kyushu, and the Izu islands through its subsidiary, Nihon Kinkyori Airways, established in 1974. Operates hotels in Asia and Hawaii through another subsidiary, ANA Enterprise Company.

Capital—\$190 million

Aircraft purchase plans—10 Boeing 767s, 2 Boeing 747s by 1988

<sup>a</sup> Dollar figures were determined at the exchange rate of 250 yen/\$1.

[ ]

**Nippon Cargo Airlines:** Established in September 1978 and acquired operating license in 1983. Six Japanese shipping companies and ANA together hold 61 percent of NCA's total stock; banks, insurance companies, trading companies, and freight forwarders own remaining stock.

Capital—\$13 million

Aircraft purchase plans—none confirmed at this time, but has already purchased 2 Boeing 747s

**Toa Domestic Airlines:** Established in May 1971 through merger of Japanese Domestic Airlines and Toa Airways. Japan's second-largest domestic airline; ranks third among Asia's passenger carriers after ANA and JAL. Ownership of the airline shared by Tokyo Electric Express Railway Company, Toa Kosan, JAL, Kinki Nippon Railway, and others. Has 60-percent holding in Japanese Air Commuter—a new carrier serving local routes in the Nansei islands.

Capital—\$38 million

Aircraft purchase plans—5 McDonnell Douglas 81s, 4 McDonnell Douglas 87s by 1990

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- The domestic business group supported NCA's request for entry into the international cargo market and is likely to press for revisions that would make ANA and TDA eligible for international passenger routes. NCA's major victory over JAL in the hard-fought battle for entry into the cargo business suggests the political clout of this group is on the upswing. ANA and the shipping lines that formed NCA have tried to coordinate their lobbying via longstanding ties to influential LDP Diet members.



Other pressures also are at work on the LDP's Aviation Committee. In particular:

- Keidanren—Japan's most prestigious big business umbrella organization—threw its support behind change in May, when it proposed the deregulation of transportation businesses, including civil aviation. Keidanren recommended to the government's special council on administrative reform that legislation pertaining to fares, licenses, and tariffs be revised and that restrictions on passenger and cargo transportation be removed. The administrative reform council—an advisory group to the Prime Minister on streamlining government—passed on recommendations for regulatory reform to Nakasone last month, and its report included a call for deregulation of the airline industry.
- The Japanese press has also climbed aboard the deregulation bandwagon. Reporting has closely followed the progress of deregulation in the United States. The press has pointed out that relaxation of regulatory controls by the Transportation Ministry could improve the international competitiveness of Japan's airlines as well as benefit domestic consumers.

Construction companies and financial groups, lured by the business prospects surrounding the new Kansai International Airport and an extension of Haneda Airport in Tokyo, are another potential influence on the LDP. For deregulation to be profitable, all parties to the debate recognize that expansion of airport capacity is required. Reports that suggest the Kansai Airport will cost \$8 billion, with an additional \$25

### **Glossary of Terms**

**Frequencies:** number of flights allowed into a country along one specific route.

**Slots:** (1) number of flights capable of landing and/or taking off in a given time period; (2) number of physical spaces to park aircraft at airports.

**Capacity:** restrictions in bilateral agreements on either flight frequencies, aircraft size, or both.

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**Regularly scheduled international flights:** commercial aircraft operations carried out regularly, with a formally established pattern of occurrences so as to constitute a scheduled international air service; determined under bilateral agreements.

**Charter flights:** irregular aircraft operations arranged by individuals, groups, or air carriers through hiring or leasing of aircraft; also determined under bilateral agreements.



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billion or \$30 billion in related infrastructural and commercial construction expenditures, are certain to spur the politically powerful construction lobby to line up solidly in favor of deregulation.

### **Progress Toward Deregulation**

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The pressure for deregulation has already produced some results. The Ministry of Transportation's decision last year to grant NCA a license to service cargo routes to the United States, which won Washington's approval in May, was an early sign of progress. JAL attempted to block the move by creating obstacles for the Japanese team negotiating with Washington for NCA's entry, but, according to the US Embassy, it was pointedly warned by the Transportation Ministry

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that it must comply with NCA's entry or risk non-renewal of the president's tenure.<sup>1</sup> The Ministry also granted ANA charter flights to Hawaii in September 1984 and will probably approve regularly scheduled routes from Tokyo to Guam. ANA is hoping for approval of regularly scheduled passenger routes from Tokyo to Los Angeles by April 1986. [ ]

Despite this progress, we do not expect rapid deregulation, and Japanese officials have said the study period to evaluate deregulation will be lengthy. Some industry and Transportation Ministry officials also have predicted deregulation in Japan probably will not go as far as that in the United States. Physical limitations on air service in Japan remain a major constraint. Although the Transportation Ministry hopes by the late 1980s to announce revisions in the aviation constitution to allow additional airlines to offer international passenger flights, the Ministry may not implement changes until new airports are built in Japan. Major airports currently are at capacity, and granting access to new airlines will not be possible until the first phase of an offshore extension project at Haneda Airport for domestic flights is completed in 1988 and the Kansai International Airport is ready in early 1993. [ ]

As the main opponent of deregulation and the carrier with the most to lose, JAL is clearly under pressure. We believe that JAL will continue to fight hard to keep its monopoly control over regularly scheduled international passenger routes, but it is also clear that the airline is positioning itself for impending change. In the short run, JAL is likely to deal with new competition by increasing its domestic routes and diversifying into new services. JAL has already applied for more routes within Japan and is involved in a new company—Japan Airship Services—that leases airships in Japan for sightseeing flights, advertisements, and aerial surveys. JAL has also devised new strategies in an attempt to retain its hold on international routes to the United States and Pacific areas. [ ]

<sup>1</sup> JAL's president is officially confirmed by the Minister of Transportation. [ ]

[ ]

Even so, we expect the domestic airline industry will keep pushing for greater access for Japanese carriers to the United States and the profitable Pacific market. The impact of industry pressure on politicians to expedite deregulation is difficult to gauge, but we believe it will probably quicken the pace. The US-Japan provisional agreement of May 1985 may have already had that effect. The agreement opened the way for more Japanese airlines to operate routes to Guam, Saipan, and the United States, and domestic airlines are anxious to compete with JAL for these routes. [ ]

A reorganization in the Transportation Ministry last year may also open the way for movement toward deregulation. The Ministry's Civil Aviation Bureau now handles only domestic aviation issues, ceding to the newly created International Transport and Tourism Bureau oversight of international air transport and shipping services. The change reduces the effectiveness of the historically strong ties between JAL and the Civil Aviation Bureau and breaks JAL's direct influence on individual bureaucrats who regulate official policy on international services. The Transportation Ministry's call for Japanese airlines to streamline their businesses and increase their operational efficiency also suggests movement to decrease direct government control. Last year, for example, the Ministry considered—but did not adopt—a program of greater pricing flexibility for domestic flights, and at least encouraged airlines to develop discount packages for use on a trial basis. [ ]

#### Implications for the United States

Deregulation should pave the way for a more competitive environment and new opportunities for US airlines serving the Pacific. Pressure by Japanese domestic airlines for access to international markets—and the US market in particular—will give Washington

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valuable bargaining chips in bilateral civil aviation negotiations. The United States won major concessions on cargo and passenger routes in return for approving NCA's entry this spring. Under the principle of reciprocity, the United States could stand to gain additional routes as more Japanese airlines break into the international market and demand routes to the United States. Although competition from an increasing number of airlines poses some downside risks, continuing market growth in the Pacific should preclude significant losses in revenue for US carriers. Japanese airlines' efforts to win pricing flexibility should also help Washington achieve its own goal of liberalizing fare setting for US airlines serving routes through Japan. [redacted]

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The expansion of airports in Japan also offers opportunities. Foreign carriers, for example, could compete for new routes, slots, and frequencies that become available as new airports open. The addition of routes for Japanese airlines when bilateral aviation agreements are renegotiated is also likely to increase Japanese demand for aircraft. According to recent press reports, ANA may buy two Boeing 747s—each valued at about \$110 million—by August 1986, and 10 Boeing 767s—costing between \$50 million and \$70 million apiece—over the next two years to service new routes. [redacted]

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Finally, Japanese Government procurement plans relating to the construction of Kansai International Airport should offer opportunities to foreign companies. According to the US Embassy in Tokyo, the Vice Minister of Transportation said in June the Ministry would favor a bidding system open to foreign contractors. The Kansai International Airport Corporation—a joint government-private-sector group responsible for construction of the airport—appears to be less forthcoming, reportedly preferring to accept foreign bids only for projects in the postconstruction phase. It has encouraged foreign firms to provide equipment and technology, however, through partnerships with established Japanese construction companies. [redacted]

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